

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 21st Floor
San Francisco, California 94105**

**NOTICE OF PROPOSED ACTION AND
NOTICE OF PUBLIC HEARING**

November 1, 2002

RH02023676

SUBJECT OF HEARING

The Insurance Commissioner proposes to adopt the regulations described below after considering comments from the public. The Commissioner proposes to add to Title 10, Chapter 5, Subchapter 3 of the California Code of Regulations the new Article 19, consisting of new Sections 2591, 2591.1, 2591.2, 2591.3, and 2591.4. The regulations will implement enforcement criteria and penalty guidelines.

AUTHORITY AND REFERENCE

The Commissioner proposes to adopt the proposed regulations under the express authority of California Insurance Code section 12921.1, subdivision (a), paragraph (7). To the extent that these regulations will apply to enforcement actions concerning the Unfair Practices Act, they are also expressly authorized by Insurance Code section 790.10. Additionally, these regulations are authorized by *CalFarm v. Deukmejian* (1989) 48 Cal.3d 805, 825 [258 Cal.Rptr. 161] and *20th Century v. Garamendi* (1994) 8 Cal. 4th 216, 280 [32 Cal.Rptr.2d 807], which recognize the Commissioner's implied authority to exercise those powers that may fairly be implied from the statute granting the powers. The proposed regulations are intended to implement those statutory provisions that recognize the Commissioner's authority to enforce the Insurance Code. The proposed regulations are also intended to implement those provisions of the Insurance Code which authorize the Commissioner to impose a penalty from within a specified range of penalties.

Specifically, the proposed regulations will implement, interpret and make specific Insurance Code sections 12921.1, subdivision (a), paragraph (7); 704.7; 769.86; 789.3; 790.035; 790.036; 790.07; 790.10; 1858.07; 1858.1; 1858.3; 1859.1; 1861.14; 10140.1; 10140.5; 10149.1; 10199.7; 10234.3; 10509.9; 11756; and 12414.25. The regulations will provide a list of criteria to determine which violations will be pursued through an enforcement action, and guidelines for determining the appropriate penalty to be assessed in connection with settlements of certain cases against insurers subject to penalties, under the following statutes: Insurance Code sections 704.7, 769.86, 789.3, 790.035, 790.036, 790.07, 1858.07, 1858.1, 1858.3, 1859.1, 1861.14, 10140.1, 10140.5, 10149.1, 10199.7, 10234.3, 10509.9, 11756, and 12414.25.

PUBLIC HEARING

The Commissioner will hold a public hearing to provide all interested persons an opportunity to present statements or arguments, either orally or in writing, with respect to this regulation, as follows:

Date and time:	December 17, 2002 - 10:00 a.m.
Location:	Department of Insurance Hearing Room 45 Fremont Street, 22nd Floor San Francisco, CA 94105

The hearing will continue on the date noted above until all testimony has been submitted or 4:00 p.m., whichever is earlier.

PRESENTATION OF WRITTEN AND/OR ORAL COMMENTS; CONTACT PERSONS

All persons are invited to present oral and/or written comments at the scheduled hearing. Written comments not presented at the hearing must be addressed to the following contact person:

Bryant Henley, Staff Counsel
California Department of Insurance
45 Fremont Street, 21st Floor
San Francisco, CA 94105
Telephone: (415) 538-4111

Questions regarding the hearing, comments, or the substance of the proposed action should be addressed to the above contact person. If the contact person is unavailable, inquiries may be sent to the backup contact person:

Lara Sweat, Staff Counsel
California Department of Insurance
45 Fremont Street, 21st Floor
San Francisco, CA 94105
Telephone: (415) 538-4192

DEADLINE FOR WRITTEN COMMENTS

All written materials must be received by the Commissioner, c/o the contact person at the address listed above, by no later than **5:00 p.m. on December 17, 2002**. Any materials received after that time will not be considered.

COMMENTS TRANSMITTED BY ELECTRONIC COMMUNICATION

The Commissioner will accept written comments transmitted by e-mail, provided they are sent to the following e-mail address: henleyb@insurance.ca.gov. The Commissioner will also accept written comments transmitted by facsimile provided they are directed to the attention of the contact person listed above. All comments sent by facsimile must be directed to the attention of Bryant Henley using the following fax number: (415) 904-5490. **Comments sent to other e-mail addresses or other facsimile numbers will not be accepted. Comments sent by e-mail or facsimile are subject to the deadline for written comments set forth above.**

ACCESS TO HEARING ROOMS

The facilities to be used for the public hearing are accessible to persons with mobility impairments. Persons with sight or hearing impairments are requested to notify the contact person (listed above) for this hearing in order to make special arrangements, if necessary.

ADVOCACY OR WITNESS FEES

Persons or groups representing the interests of consumers may be entitled to reasonable advocacy fees, witness fees, and other reasonable expenses, in accordance with the provisions of subchapter 4.5, title 10, of the California Code of Regulations, in connection with their participation in this matter. Persons interested in inquiring about the appropriate procedures should contact the Office of the Public Advisor at the following address:

California Department of Insurance
Office of the Public Advisor
300 Capitol Mall, 17th Floor
Sacramento, CA 95814
(916) 492-3559

A copy of any written materials submitted to the Public Advisor regarding this rulemaking must also be submitted to the contact person for this hearing, listed above. Please contact the Office of the Public Advisor for further information.

INFORMATIVE DIGEST

Summary of Existing Law

Because the tool of settlement is administratively efficient and furthers one of the purposes for which State agencies are created, the Department has the implied power to settle enforcement actions prior to a full hearing in accordance with the Administrative Procedures Act. (*Rich Vision Centers, Inc. v. Board of Medical Examiners* (1983) 144 Cal.App.3d 110, 115 [192 Cal.Rptr. 455].) There are no limitations on the conditions that may be included in a settlement except that such conditions cannot violate public policy, statute or regulation. (Id at p. 115-116; see also Gov. Code § 11415.60.) The purpose of these proposed regulations is to promote effective and equitable settlement of Department actions by promulgating guidelines for the

enforcement and settlement of enforcement actions. The Commissioner, in proposing these regulations, recognizes that the Department “must have flexibility in formulating the terms and conditions of any agreement to maximize benefit to the [agency].” . (*Rich Vision Centers, Inc. v. Board of Medical Examiners* (1983) 144 Cal.App.3d 110, 116 [192 Cal.Rptr. 455].)

Insurance Code section 790.10 authorizes the Commissioner to promulgate reasonable rules and regulations as are necessary to administer the Unfair Practices Act (Insurance Code § 790, et seq.). Insurance Code section 12921.1, subdivision (a), paragraph (7) requires that the commissioner establish a list of criteria for enforcement actions and penalties. Additionally, the Department’s powers are not limited to those expressly granted in the legislation. The Department may also exercise such additional powers as are necessary for the due and efficient administration of powers expressly granted by statute, or as may fairly be implied from the statute granting the Department’s powers. (*CalFarm v. Deukmejian* (1989) 48 Cal.3d 805, 825 [258 Cal.Rptr. 161] and *20th Century v. Garamendi* (1994) 8 Cal. 4th 216, 280 [32 Cal.Rptr.2d 807].) Through the adoption of these regulations, the Commissioner intends to utilize his implied power to develop criteria for use in settling enforcement actions based upon violations of the Insurance Code. Specifically, the criteria will be used to determine which violations should be pursued through an enforcement action. Additionally, the Commissioner intends to promulgate guidelines to aid in determining the appropriate penalty for each violation based upon the nature, severity and frequency of the violation.

Insurance Code sections 704.7, 769.86, 789.3, 790.035, 790.036, 790.07, 1858.07, 1858.1, 1858.3, 1859.1, 1861.14, 10140.1, 10140.5, 10149.1, 10199.7, 10234.3, 10509.9, 11756, and 12414.25 provide penalty ranges for various violations of the Insurance Code. Some provisions authorize the Commissioner to impose a fine within a range “not to exceed” a certain penalty maximum. Other provisions authorize the Commissioner to impose a penalty of “no less than” a certain penalty minimum. The common variable with respect to each of these provisions is that none of the provisions provide a detailed list of criteria for calculating the appropriate penalty from within the range. For example, Insurance Code section 704.7 authorizes the Commissioner to impose a fine which “shall not exceed fifty-five thousand dollars,” but it does not provide any direction as to how the Commissioner should exercise his discretion to determine a penalty amount below \$55,000. The proposed regulations will aid the Commissioner’s efforts to determine the appropriate penalty amount by providing guidelines for enforcement and penalty amount.

Policy Statement Overview

These regulations are intended to provide greater uniformity in enforcement and in the assessment of penalties imposed upon insurers. The regulations will establish a list of criteria to be used to determine the nature, severity and frequency of each violation and will help to ensure that each imposed penalty will appropriately fit the observed violation. The decisions to engage in an enforcement action, and to determine the appropriate penalty must take into account a number of factors, which vary from case to case. The Commissioner recognizes that it is impossible to anticipate every significant factor that might affect each decision to conduct an enforcement action, or the determination of the appropriate penalty for each given case. These regulations, therefore, do not attempt to impose a rigid, inflexible formula for enforcement and

penalty determinations. Instead, the Commissioner has decided upon a more flexible approach, designed to ensure that the Department will consider each case on its own facts and independently weigh the significance of each violation as well as the impact of the violation on the general public. Because the guidelines in this proposal are designed to aid the Department in settling enforcement actions equitably, these regulations are intended to apply solely to those cases where the parties have agreed to resolve the dispute through a settlement agreement.

To determine whether an enforcement action will be pursued, and to determine the appropriate penalty, the Commissioner proposes a list of relevant considerations. The Commissioner has determined that the relevant considerations are the detrimental impact and severity of the violation, the frequency of the occurrence of the violation, whether the violation was willful, the financial effect of the violation, the violator's compliance record, the length of the non-compliant activity, whether extraordinary circumstances exist, whether actions have been taken against previous insurers, the financial strength of the violator, and the degree to which a penalty or enforcement action may deter future violations. The importance of each of these considerations will vary from case to case, and the Commissioner will give to each consideration a weight, or no weight, as is deemed appropriate under the circumstances. These regulations also allow the Commissioner to expressly identify and take into account unique considerations, other than those listed in the regulations, so that the determination of whether or not to pursue an enforcement action and the decision as to the amount of the penalty to be assessed can in each case be arrived at equitably, depending on the facts surrounding the particular violation.

Finally, the regulations provide examples of how these criteria would be applied to hypothetical violations. The amount of penalty to be imposed will depend upon the seriousness of the violation. The amount of penalty will also depend upon which statutory penalty provisions are applicable to the violation identified.

Effect of Proposed Action

Currently, the Department does not have formal criteria in place to decide which cases should be pursued through an enforcement proceeding and to determine the appropriate penalty for each case. The proposed regulations will change this. The proposed regulations will provide a formal structure for deciding when to conduct an enforcement action. Similarly, while existing penalty statutes within the Insurance Code provide penalty ranges, they leave considerable latitude to the Department in the selection of the appropriate penalty from within the penalty range applicable to any given case. The proposed regulations will enable this discretionary penalty power to be exercised more methodically by providing guidelines by which the Department can more effectively ensure uniformity and consistency of penalties for similar circumstances.

The decisions to conduct an enforcement action and to demand a particular penalty, naturally, occur prior to an enforcement hearing. The proposed regulations will not affect cases in which an insurer disputes the existence of a violation and which result in an administrative order or judicial decision. However, the criteria and guidelines proposed herein will facilitate the Department's assessment of issues commonly confronted during settlement negotiations. The effect of the proposed regulations will be to provide greater transparency in the settlement

negotiation process. Further, in the event that the Commissioner relies on criteria other than those provided in the proposed regulations, those criteria will be required to be expressly stated.

PUBLIC DISCUSSIONS OF PROPOSED REGULATIONS

Pursuant to Government Code Section 11346.45, the Department mailed an Invitation to Prenotice Public Discussions to a number of consumer-group and insurer-group representatives. Subsequently, the Department held a one-day workshop in order to receive comments about the proposed regulation. Input from workshop participants was taken into account in the formulation of the proposed regulations.

MANDATES ON LOCAL AGENCIES OR SCHOOL DISTRICTS OR COSTS WHICH MUST BE REIMBURSED PURSUANT TO GOVERNMENT CODE SECTIONS 17500 THROUGH 17630

This proposed regulation does not impose any mandate on local agencies or school districts. There are no costs to local agencies or school districts for which Part 7 (commencing with Section 17500) of Division 4 of the Government Code would require reimbursement.

COST OR SAVINGS TO ANY STATE AGENCY

The Commissioner has determined that the proposed regulations will result in no cost or savings to any state agency, no cost to any local agency or school district that is required to be reimbursed, no other nondiscretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State.

ECONOMIC IMPACT ON BUSINESSES AND THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE WITH OTHER STATES

The Department has made an initial determination that the adoption of this regulation may have a significant statewide adverse economic impact on businesses, including the ability of California businesses to compete with businesses in other states. The Department has not considered proposed alternatives that would lessen any adverse economic impact on business and invites you to submit proposals. Submissions may include the following considerations:

- (i) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to businesses.
- (ii) Consolidation or simplification of compliance and reporting requirements for businesses.
- (iii) The use of performance standards rather than prescriptive standards.
- (iv) Exemption or partial exemption from the regulatory requirements for businesses.

The types of businesses affected by the proposed regulations are insurers that transact insurance in the State of California.

POTENTIAL COST IMPACT ON PRIVATE PERSONS OR BUSINESSES

The Department is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

EFFECT ON JOBS IN CALIFORNIA

The Commissioner is required to assess any impact the regulations may have on the creation or elimination of jobs in the State of California, the creation of new businesses, the elimination of new businesses, and the expansion of businesses currently operating in the state. The Commissioner does not foresee that the proposed regulations will have an impact on any of the above but invites interested parties to comment on this issue.

IMPACT ON HOUSING COSTS

The matters proposed herein will have no significant effect on housing costs.

ALTERNATIVES

The Commissioner must determine that no reasonable alternative considered by the Commissioner or that has otherwise been identified and brought to the attention of the Commissioner would be more effective in carrying out the purposes for which the regulations are proposed or would be as effective and less burdensome to affected private persons than the proposed action. The purpose of the proposed regulation is to implement a statutory mandate. To date, no reasonable alternative to the proposed regulations is apparent. The Commissioner, however, invites public comment on alternatives to the regulation.

IMPACT ON SMALL BUSINESS

The matters proposed herein will only affect insurance companies, and therefore will not affect small business. (Gov. Code § 11342.610, subd. (b), para. (2).)

COMPARABLE FEDERAL LAW

There are no existing federal regulations or statutes comparable to the proposed regulations.

TEXT OF REGULATIONS AND STATEMENT OF REASONS

The Commissioner has prepared an initial statement of reasons that sets forth the reasons for the proposed action. The Commissioner also has available all the information upon which this proposed action is based and the express terms of the proposed action. Upon request, the initial statement of reasons will be made available for inspection and copying. Requests for the initial statement of reasons or questions regarding this proceeding should be directed to the contact person listed above. Upon request, the final statement of reasons will be made available for inspection and copying once it has been prepared. Requests for the final statement of reasons should be directed to the contact person listed above.

The file for this proceeding, which includes a copy of the proposed regulations, the statement of reasons, the information upon which the proposed action is based, and any supplemental information contained in the rulemaking file, is available for inspection and copying **by prior appointment** at 45 Fremont Street, 21st Floor, San Francisco, California, 94105, between the hours of 9:00 a.m. and 4:30 p.m., Monday through Friday. Written requests for the rulemaking file or questions regarding this proceeding should be directed to the contact persons listed above.

FINAL STATEMENT OF REASONS

Upon **written or e-mail** request, the final statement of reasons will be made available for inspection and copying once it has been prepared. Written requests for the final statement of reasons should be directed to the contact person listed above.

AUTOMATIC MAILING

A copy of this notice, including the informative digest, which contains the general substance of the proposed regulations, will automatically be sent to all persons on the Commissioner's mailing list.

WEBSITE POSTINGS

Documents concerning this proceeding are available on the Department's website. To access them, go to <http://www.insurance.ca.gov>. Find near the top of the page the major heading 'Protecting Consumers.' In this section, scroll down until you see the subheading 'BE INFORMED.' Click on the nearby 'Proposed Regulations — Search' link. When the 'Search or Browse for Documents for Proposed Regulations' screen appears, you may choose to find the documents either by conducting a search or by browsing for them by name.

To search, enter "RH02023676" (the Department's regulation file number for these regulations) in the 'Search for' field. Alternatively, search using as your search term the California Insurance Code number of a code section that the regulations implement (for instance, "12921.1"), or search by keyword ("penalty," for example or "enforcement"). Then, click on the 'Submit' button to display links to the various filing documents.

To browse, click on the 'Browse All Regulations' button near the bottom of the screen. A list of the names of regulations for which documents are posted will appear. Find in the list the 'Enforcement Actions and Penalties' link, and click it. Links to the documents associated with these regulations will then be displayed.

AVAILABILITY OF MODIFIED TEXT OF REGULATION

If the regulations adopted by the Department differ from but are sufficiently related to the original text, the Department will make the modified text available to the public for at least 15 days prior to the date of adoption. Interested persons should request a copy of these regulations prior to adoption from the contact person listed above.

Dated: November 1, 2002

HARRY W. LOW
Insurance Commissioner

By _____
Bryant Henley
Staff Counsel